Supreme Court, U.S.
FILED
JUL 22 2002
OFFICE OF THE CLERK

No. 01-1692

IN THE
SUPREME COURT OF THE UNITED STATES

MIDWEST GAS USERS' ASSOCIATION,

Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, et al.,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF RESPONDENT, WILLIAMS GAS PIPELINES CENTRAL, INC. IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Gary W. Boyle
Counsel of Record for Respondent
Williams Gas Pipelines Central, Inc.
The Williams Companies, Inc.
P. O. Box 2400
Tulsa, OK 74102
(918) 573-2359 (telephone)
(918) 573-4195 (facsimile)

RESPONSE TO PETITIONER'S QUESTION PRESENTED

Petitioner's statement of the Question Presented is inconsistent with Rule 16(2) of the Rules of the Supreme Court. Properly stated, the question presented by the Petition is:

Does FERC have the authority to direct the refund of prices paid for gas in transactions over which FERC had no jurisdiction?

RULE 29.6 STATEMENT

Respondent Williams Gas Pipelines Central, Inc., is wholly owned by Williams Gas Pipeline Company, LLC. Williams Gas Pipeline Company, LLC is owned by The Williams Companies, Inc.

TABLE OF CONTENTS

	Page
Questions Presented	i
Statement Pursuant to Rule 29.6	ii
Table of Contents	iii
Table of Authorities	iv
Table of Appendices	v
Response to Petitioner's Reasons for Granting the Writ	1
A. This Case Is Not The Type Contemplated By Rule 10 . . .	1
B. FERC's Jurisdiction With Respect To Distributions To Non-Jurisdictional Customers Is The Settled Law Of This Case	4
C. The Petitioner Has Other Adequate Remedies	5
Conclusion	6

TABLE OF AUTHORITIES

Page

Court Cases

FERC v. Martin Exploration Management Co.,
486 U.S. 204 (1988) 2

Northwest Central Pipeline Corp. v.
State Corporation Commission,
489 U.S. 493 (1989) 2

Public Service Co. of Colorado v. FERC,
91 F.3d 1478 (D.C. Cir. 1996),
cert. denied, 520 U.S. 1224 (1997) . . . 4, 5

State of New York v. FERC, 535 U.S. _____,
122 S. Ct. 1012, 152 L.Ed. 2d 47,
70 U.S.L.W. 4166 (2002) 2

Administrative Materials

Colorado Interstate Gas Co.,
65 FERC ¶ 61, 292 (1993) 4

TABLE OF APPENDICES

Page

Appendix A - *Colorado Interstate Gas Company,* Docket Nos. GP83-11-002 and RI83-9-003, Order on Court Remand dated December 1, 1993. 1

Respondent, Williams Gas Pipelines Central, Inc., ("Williams"), hereby files its Brief in Opposition to Petitioner's Writ of Certiorari.

RESPONSE TO PETITIONER'S REASONS FOR GRANTING THE WRIT

A. This Case Is Not The Type Contemplated By Rule 10.

Petitioner purports to describe two reasons for granting the Writ. Petition for a Writ of Certiorari (hereinafter "Petition") at 8-9. Stripped down to their real substance, Petitioner's reasons are: (1) FERC's actions will redistribute millions of dollars from certain pipeline customers to other pipeline customers, and (2) FERC's actions will deny some retail gas customers in Kansas relief from prices in excess of the Maximum Lawful Price. Even if Petitioner's assertions are correct (which Williams denies) the stated reasons do not support granting the Writ.

Rule 10 of the Rules of the Supreme Court provides examples of the reasons that this Court may consider sufficiently compelling to support the granting of a Writ of Certiorari. Those relevant here include a conflict between the circuits on an important matter; a conflict between a circuit court of appeals and a state court of last resort on an important matter; a departure from the normal course so extraordinary that the Court must exercise its supervisory powers; and a decision of first impression or a decision in conflict with decisions of this Court on an important federal question.

This case does not fall within any of the Rule 10 categories and Petitioner has not articulated a basis on which the Court might reasonably conclude otherwise. Similarly, Petitioner has not articulated a basis on which the Court might conclude that the questions presented in this Petition are compelling for any other reason. Petitioner has failed to state a sufficient reason to grant the Writ probably because FERC's lack of jurisdiction over the transactions at issue here is well settled.[1]

Petitioner suggests that the Court of Appeals' decision is contrary to this Court's recent holding in *State of New York v. FERC*, 535 U.S. ____, 122 S. Ct. 1012, 152 L. Ed. 2d 47 (2002). Petition at 14-16. That case, however, stands for the proposition that when an electric utility unbundles the electric commodity from the electric transmission service, FERC has the jurisdiction to require the utility to offer its transmission service to others on an open access basis. *Id.* 122 S. Ct. at 1016, 152 L. Ed. 2d at 54. While that proposition is also well settled with respect to FERC's jurisdiction over natural gas transmission, it has no relationship at all to the questions presented here. Contrary to Petitioner's assertion, this case concerns FERC's ability to control the sale of gas not in interstate commerce. It does not deal with open access to gas or electric transmission facilities and indeed has no relationship to transmission service at all. Accordingly, *State of New York v. FERC* is simply irrelevant to the issues presented in this case.

Petitioner's reliance on *FERC v. Martin Exploration Management Co.*, 486 U.S. 204 (1988) is also misplaced. In Martin, the Court held that FERC has the authority to set the rules under which gas would be categorized for the purpose of

---

1 *Northwest Central Pipeline Corp. v. State Corporation Comm'n of Kansas*, 489 U.S. 493 at 525 (1989).

setting the NGPA Maximum Lawful Price while leaving to the states and other federal agencies the application of those rules. *Id.* at 213. That is exactly what FERC has done here. By approving the settlement in question, FERC has set the rules under which money will be passed to certain classes of customers. FERC properly left the application of its rules concerning distribution of those funds among classes of customers outside of its jurisdiction to the appropriate state regulatory agencies. FERC's approval of the settlement in this case is entirely consistent with *Martin* and does not warrant further review.

This case does not raise a conflict between the circuits or a circuit and a state court. Petitioner does not claim that this case presents a question of first impression. An examination of the Court's allegedly relevant decisions reveals that the Court of Appeals' decision is consistent with decisions of this Court. There is no claim of an extraordinary departure from the normal course. Perhaps most telling, the Petitioner has declined to argue that any of the questions presented here are important in the context of the Court's docket.[2]

Because the Petitioner has failed to articulate, in accordance with Rule 10, a compelling reason to grant the Writ, the Petition should be denied.

---

2 Petitioner's request for a writ may be best explained by the fact that its filing delays the Effective Date of the Settlement, a fact which Petitioner apparently hopes will place additional pressure on the other parties to agree to an extortionate settlement of Petitioner's specious claims.

B. FERC's Jurisdiction With Respect To Distributions To Non-Jurisdictional Customers Is The Settled Law Of This Case.

Petitioner asks the Court to change FERC's position and direct FERC to control distributions of proceeds to retail customers in Kansas. Notwithstanding Petitioner's protestations, the distribution of the proceeds of Kansas *ad valorem* tax refunds is the well-settled law of this case and has not been properly preserved by any party for consideration here. FERC long ago established that it would not attempt to assert jurisdiction over the disposition of refunds attributable to non-jurisdictional pipeline customers and its initial decisions have been appealed without complaint. At this late juncture, this Court should not accept this "controversy" when Petitioner declined to seek review of FERC's prior decisions.

FERC first established a process for collecting and distributing refunds of Kansas *ad valorem* taxes collected in excess of the Maximum Lawful Price in *Colorado Interstate Gas Co.*, 65 FERC ¶ 61,292 (1993) (Appendix A). FERC directed pipelines who initially paid Kansas *ad valorem* taxes to producers to request a refund of the amounts so paid. *Id.* at 62,373 (Appendix A at 20). FERC also established the manner in which pipelines would pass through refunds to customers. *Id.* at 62,373-374 (Appendix A at 20-22). FERC established in 1993 that it would direct the pipelines to refund the jurisdictional portion of their collections but would not direct distribution by pipelines with respect to the non-jurisdictional portion of their collections. *Id.* at 62,374 (Appendix A at 21-22).

FERC's decision was thoroughly reviewed by the Court of Appeals for the District of Columbia Circuit. *Public Service Co. of Colorado v. FERC*, 91 F.3d 1478 (1996), *cert. denied,*

520 U.S. 1224 (1997). Notwithstanding an opportunity to raise its arguments at that time, Petitioner declined to participate in that appeal and the Court declined to grant a Petition for Writ of Certiorari. Because Petitioner failed to challenge FERC's decision not to assert jurisdiction over the very refunds at issue here, the Court should not engage in a seriously delayed review now.

C. The Petitioner Has Other Adequate Remedies.

Petitioner bases much of its argument on the proposition that consumers of gas will be left with no adequate remedy (Petition at 18) unless this Court intervenes to dismantle a reasonable settlement of a regulatory proceeding entered into between properly motivated parties and approved by an agency with sufficient expertise to understand and to determine the propriety of a complicated and delicately balanced settlement. While it is clear that lack of a remedy is not a sufficient reason to support a Petition for a Writ of Certiorari, it is equally clear that Petitioner has other adequate remedies.

The settlement at issue in this case allocated a percentage of the proceeds from the refund of tax overcharges to Kansas Non-Jurisdictional Customers (Appendix A to Petition at 11a). Under the terms of the settlement, the ultimate distribution to the Kansas non-jurisdictional customers was left to the Kansas Corporation Commission (hereinafter the "KCC") (Appendix A to Petition at 13a-15a). Petitioner's sole objection is that the KCC will be free to distribute the Kansas non-jurisdictional portion of the refunds in a way with which the Petitioner disagrees (Petition at 6-8). The power to direct distribution of a portion of the settlement fund lies squarely with the KCC. If Petitioner is aggrieved by a KCC ruling, it

can pursue a remedy through the courts of Kansas and eventually, if appropriate, in this Court on a Petition for a Writ of Certiorari to the Supreme Court of Kansas. Petitioner makes no argument that it cannot avail itself of such an appropriate appellate process. For these reasons, Petitioner's claim of a lack of remedy is inaccurate and insufficient to support its Petition.

CONCLUSION

Petitioner's Writ does not present an issue appropriate for review by this Court pursuant to Rule 10. Additionally, the issues presented to this Court have previously been subjected to an exhaustive appellate process. The Court should deny the Petition for Writ of Certiorari.

Respectfully submitted,

Gary W. Boyle
Counsel of Record for Respondent
Williams Gas Pipelines Central, Inc.
The Williams Companies, Inc.
P. O. Box 2400
Tulsa, OK 74102
(918) 573-2359 (telephone)
(918) 573-4195 (facsimile)

July 22, 2002

APPENDIX

APENDIX A – ORDER ON COURT REMAND ISSUED DECEMBER 1, 1993

UNITED STATES OF AMERICA 65 FERC ¶ 61,292 FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: **Elizabeth Anne Moler, Chair; Vicky A. Bailey, James J. Hoecker, William L. Massey, and Donald F. Santa, Jr.**

Colorado Interstate Gas Company

Docket Nos. GP83-11-002 and RI83-9-003

ORDER ON COURT REMAND

(Issued December 1, 1993)

On June 28, 1988, the United States Court of Appeals for the District of Columbia in *Colorado Interstate Natural Gas Co. v. FERC*, 850 F.2d 769 (D.C. Cir. 1988) (CIG) remanded to the Commission its decision in *Sun Exploration and Production Co. and Northern Natural Gas Co.* (Sun).[1] In Sun, the Commission held that the Kansas *ad valorem*[2] tax was similar to a severance tax, and thus qualified for reimbursement under section 110(a)(1) of the Natural Gas Policy Act of 1978 (NGPA). The Commission now reverses its decision in Sun, concludes that the Kansas *ad valorem* tax does not qualify under

---

1 36 FERC ¶ 61,093 (1986); *reh'g denied, Northern Natural Gas Co.*, 38 FERC ¶ 61,062 (1987).

2 See appendix.

under section 110(a)(1) of the NGPA, and orders refunds consistent with this order, effective as of the date of the court's decision.

Introduction

In 1974, in Opinion No. 699, the Commission set a uniform national rate under the Natural Gas Act for producer sales of gas, which could be increased to recover "State production, severance or similar taxes."[3] In Opinion No. 699-D, the FPC held that any State *ad valorem* tax that was "based on production factors" was a "similar tax" which could be added to the national rate.[4] In response to a specific request for a ruling on the eligibility of the Kansas *ad valorem* tax, the FPC held the tax qualified because "the bulk of the Kansas *ad valorem* tax is based upon production factors."[5] The FPC went

---

3 Just *and Reasonable National Rates for Sales of Natural Gas,* Opinion No. 699, 51 FPC 2212, 2301-2, reh'g denied in relevant part, 52 FPC 1604 (1974), aff'd sub nom., *Shell Oil Co. v. FPC,* 520 F.2d 1061 (5th Cir. 1975), reh'g denied, 525 F.2d 1261 (5th Cir.), cert. denied sub nom. *California Co. v. FPC,* 426 U.S. 941 (1976).

4 See generally, Opinion No. 699-D, *Just and Reasonable National Rates for Sales of Natural Gas,* 52 FPC 915 (1974), and *Mobil Oil Corp.,* 55 FPC 917 (1976).

5 On December 31, 1975, the Commission set a national rate for gas flowing in interstate commerce prior to January 1, 1973 and continued to permit reimbursement of "State . . . production, severance, or similar taxes." Just *and Reasonable National Rates for Sales of Natural Gas,* 54 FPC 3090, 3124 (1975), reh. denied, 56 FPC 303 (1976), *aff'd in relevant part sub nom. Tenneco Oil Co. v. FPC,* 571 F.2d 834 (5th Cir.), *cert. denied,* 439 U.S. 801 (1978). In updating national rates for the 1975-76 period, the Commission adhered to its standard for tax reimbursement. *National Rates for Jurisdiction Sales of Natural Gas,* 56 FPC 509, 591, *reh. denied in relevant part,* 56 FPC 3698, 2807 (1976), *aff'd sub nom., American Public Gas Ass'n v. FERC,* 567 F.2d 1016 (D.C. Cir. 1977), *cert. denied,* 435 U.S. 907 (1978).

on to explain that other states' taxes also could similarly qualify because they were taxes "on the amount of production and the revenues therefrom." However, on March 1, 1976, the FPC held that the Texas *ad valorem* tax was not a production, severance, or similar tax.[6] The FPC explained that although annual and future production of gas was used to determine the value of the gas property being taxed, "the tax itself does not depend on production" but rather "depends on the value of the remaining recoverable reserves."[7] The FPC noted that under the Texas tax "a gas property which had no production at all during a tax period due to a temporary shut-down would still have value and would incur tax liability in the period on that basis."[8]

The NGPA, enacted effective December 1, 1978, set maximum lawful prices (MLP) for the first sale of certain categories of natural gas. Under NGPA section 110(a)(1), the first sale price could exceed the MLP to the extent necessary to recover "State severance taxes attributable to the production of such natural gas."[9] The NGPA defined "State severance tax," as "any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas."[10] The Conference Report accompanying the NGPA stated that the term "State severance tax" is to be "construed broadly" and includes "any

---

6 *Mobil Oil Corp.*, 55 FPC 917 (1976) (Mobil).

7 *Id.* at p. 918.

8 *Id.* at p. 918.

9 15 U.S.C. §§ 3320(a).

10 15 U.S.C. §§ 3320(c).

tax imposed upon mineral or natural resource production including an *ad valorem* tax or a gross receipts tax."[11]

On January 11, 1983, Sun Exploration and Production Company (Sun) petitioned the Commission to issue a declaratory order, retroactive to December 1, 1978, asserting that the Texas *ad valorem* tax is a reimbursable severance tax under section 110. Subsequently, on August 22, 1983, Northern Natural Gas Company (Northern) petitioned the Commission to rescind the holding in Opinion No. 699-D that the Kansas *ad valorem* tax is reimbursable under section 110.[12] On July 23, 1986, the Commission issued the order in Sun dealing with both petitions and denying them both on the merits.[13] Although the Commission observed that both the Kansas and Texas taxes were defined by statute as property taxes levied upon the fair market value of remaining recoverable reserves at the time of the assessment, the Commission found that the two taxes differed in "the degree to which production factors are taken into account." The Commission found that the Kansas methodology differed from the Texas methodology insofar as "actual current or prior-years' production volumes or the revenues derived therefrom are a significant factor in the formula used to determine the Kansas tax."[14] The Commission found that the Texas methodology only uses actual production to establish the rate of production decline for projecting future production and estimating

---

11 S. Rep No. 95-1126, 95th Cong. 2d Sess. at p. 91.

12 Numerous parties intervened, including Colorado Interstate Gas Co. (CIG), which supported Northern's petition.

13 The court upheld the Commission's refusal to dismiss the petitions on grounds of res judicata. 850 F.2d at p. 772.

14 36 FERC ¶ 61,093, at p. 61,224 (emphasis in original).

remaining reserves. Further, the Commission reasoned, Texas has long assessed both a severance tax and an *ad valorem* tax, indicating that Texas considered the taxes to be separate and distinct. The order also rejected the argument that the Texas tax should qualify because of the statement in the Conference Report accompanying the NGPA that the term "State severance tax" is to be construed broadly. The Commission stated that the tax still must be "upon . . . . production."[15] Finally, the Commission rejected Northern's various arguments that the Kansas *ad valorem* tax is a property tax.

Northern and CIG filed requests for rehearing regarding the portion of the July 23, 1986, order addressing the Kansas tax. No party filed for rehearing of the Commission's ruling on the Texas tax. On January 28, 1987, the Commission denied rehearing on the same grounds as stated in the July 23, 1986, order.[16] Northern and CIG then sought court review of the Commission's ruling that the Kansas tax qualified under NGPA section 110.

In reviewing the Commission's orders, the court rejected each of the Commission's arguments justifying its decision. The court noted that "a tax nominally on property may be functionally identical to a production tax. "[17] However, the court held that to find a tax was similar to a production tax, it would not be sufficient to merely find, as the Commission did, that the "bulk of the Kansas tax is based upon production factors." Rather there had to be a systematic analysis of any tax "by reference to [a] cogent theory of what makes a tax 'similar'

---

15 36 FERC ¶ 61,093, at p. 61,224.

16 *Northern Natural Gas Co.*, 38 FERC ¶ 61,062 (1987).

17 850 F.2d at p. 772.

to a production or severance tax under §§ 110."[18] In particular reference to the Kansas tax, the court noted that the Commission had not identified those features that it believes constitute the production "bulk," much less the features excluded from the bulk. The court explained that in Kansas the ultimate tax on equal production may vary nearly by a factor of ten "because production is capitalized by multiplying by a present worth factor."[19]

The court also was unpersuaded by the Commission's reasons for treating the Kansas and Texas taxes differently since it found that both statutes assessed the cash market value of remaining recoverable reserves. Accordingly, the court remanded the case to the Commission for an analysis "to identify the features of the Kansas tax that point toward one classification or another, and to offer sensible distinctions between taxes that it chooses to treat differently."[20]

KCC Motion to Reaffirm

On January 31, 1989, KCC filed a motion requesting the Commission to reaffirm its 1987 Sun decision.[21] The KCC

---

18 *Id.* at p. 773.

19 *Id.* at p. 771. The Court noted that the present worth factors in Kansas incorporate several assumptions including: an assumed discount rate, expectations as to future price changes, assumptions about rates of decline in production, and the probable length or production

20 *Id.* at p. 775. The court noted that with the gradual elimination of federal regulation of natural gas prices, any change by the Commission could be of limited relevance. Since the court's decision, as a result of the Natural Gas Wellhead Decontrol Act of 1989, Pub. L.101-50, 103 Stat. 158, as of January 1, 1993, there no longer is any price regulation of natural gas.

21 Attached to the KCC motion was the affidavit of Mr. Timothy N. Hagemann, a Kansas certified County Appraiser, which described how the ad

argues that in its practical operation, the Kansas *ad valorem* tax is similar to a severance or production tax and should qualify under section 110. Kansas asserts that although nothing in the public record reflects the precise source of the language adopted in section 110 of the NGPA, it is reasonable to assume that the Conference Committee accompanying the NGPA meant to adopt the policy of the FPC -- permitting Kansas producers to collect the *ad valorem* tax. The KCC asserts that a tax is "similar" to a severance or production tax under section 110 of the NGPA if the tax varies with the amount of natural gas produced.

The KCC states that a property's fair market value varies directly with the amount of gas produced from wells on the property and all other things being equal, a well that produces more gas than a neighboring well in the same field will be appraised at a higher value than the other well. Since the tax in Kansas is proportional to production, the Sun decision, that the Kansas tax is similar to a production tax, should be affirmed. KCC argues that to deny reimbursement of the tax would operate as an economic disincentive to production of natural gas.

CIG's Answer

On March 1, 1989, CIG filed an answer to the KCC motion to reaffirm.[22] CIG argues that the Kansas *ad valorem* tax is not assessed primarily on the volume or value of current production and does not constitute a production, severance, or similar tax under section 110 of the NGPA. CIG asserts that

---

valorem tax operated in Kansas.

22 Northern filed an answer opposing KCC's motion for the reasons set forth by the court in CIG, and by CIG in its answer.

the KCC's position -- that a tax is similar to a severance or production tax if it varies with the amount of natural gas produced -- is no more cogent than the arguments presented by the Commission and rejected by the court in CIG. CIG argues that, under section 110, Congress intended that only taxes and certain other specific costs which are directly related to the volume and value of gas currently produced would be reimbursable such as the other NGPA section 110 costs (i.e., gathering, compression, treating, etc.) which are volumetrically related to the gas produced and sold. CIG asserts that the Kansas *ad valorem* tax is not assessed on the value of the gas sold and produced in any particular year, but instead is assessed on the value of the gas remaining in the reservoir after each year's production is removed.

CIG further states that in defining severance taxes, Congress used the words of the FPC's Opinion No. 699, but added the phrase "imposed on the production of natural gas." (CIG pet. at p. 13). CIG argues that where a tax is not imposed on production, but instead on the leasehold property, like the Kansas *ad valorem* tax, Congress did not intend that such a tax would be reimbursable. CIG contends that although production plays a role in the assessment of the Kansas *ad valorem* tax, it is not a determinative role. To establish that production is not the determining factor in the tax, CIG points out that two wells in different fields producing equal amounts of natural gas can generate different amounts of tax because the *ad valorem* tax uses a Present Worth Factor[23] in calculating the tax assessment. CIG argues that the KCC has focused on the operation of the Kansas tax within a given field, which conceals the true nature of the tax. While at the "microscopic"

---

23 As described in the Hagemann affidavit, the Present Worth Factor is a complex mathematical function of time, anticipated price escalation, time value of money, discount rate, and a production decline rate.

field level the tax appears to be one based primarily on the value of production, when examined at the state-wide, "macroscopic" level, as the tax is assessed in the various Kansas producing fields, the full nature of the tax emerges. CIG asserts that when viewed from both perspectives, it is clear that the tax fails to resemble a production or severance tax.[24]

Other Pleadings

On August 5, 1993, Missouri Public Service Commission (Missouri), and Southern Union Gas Company (Southern)[25] moved to intervene out of time, and filed a joint motion for summary reversal of the Commission's determination that Kansas' tax was similar to a production tax. On August 20, 1993, four natural gas producers, who had previously filed in support of KCC's motion, filed an answer opposing the joint motion, and urged the Commission to reaffirm its prior rulings on the Kansas tax.

Discussion

A. *Qualification of the Kansas Ad Valorem Tax under Section 110*

---

24 CIG states that the Commission should not act without a full record and suggests that the Commission establish procedures to develop such a record. On April 14, 1989 the KCC responded to CIG's Answer by arguing that the interpretation of section 110 and the inferences that may be drawn from the operation of the Kansas tax call for legal analysis and not a factual evidentiary hearing, and submitted additional affidavits confirming that the description of the tax in the Hagemann affidavit was correct. (KCC motion to Lodge at p. 2.).

25 Each claimed that it was involved in current proceedings which are dependent on the outcome of this proceeding. The Commission finds that good cause has been demonstrated and grants intervention under Commission rule 214(d)(1), 18 C. F. R. § 385.214(d)(1)(1993).

Although there are various types of taxes that producers pay, such as real estate taxes, personal property taxes, sales taxes, income taxes, excise taxes, and so forth, section 110 of the NGPA only permits the reimbursement of "State severance taxes borne by the seller" in addition to the ceiling price. These allowed taxes, in turn, are defined by the NGPA as "any severance, production, or similar tax." Other taxes are costs of doing business that the producer was to recover by the collection of the ceiling price. As clarified further in the legislative history, "State severance tax" is a statutory term of art that "includes any tax imposed upon mineral or natural resource production including an *ad valorem* tax or a gross receipts tax" and is to be "broadly construed."[26] Upon reconsideration of the Kansas *ad valorem* tax in light of the language of the NGPA, the court's decision, and the facts of this case, including the text and application of the Kansas statute, the Commission finds that the tax does not qualify under section 110(a)(1) of the NGPA. The Commission finds that, for reasons as argued by CIG and Missouri, and as clarified further below, the Kansas *ad valorem* tax is not similar to a severance tax and is, instead, a non-qualifying personal property tax.

1. Standards for Analyzing the Kansas Ad Valorem Tax

The Commission in Sun applied the standard that the Kansas tax qualified under NGPA section 110 because "actual current or prior-years' production volumes or the revenues derived therefrom are a significant factor in the formula used to determine the tax."[27] This standard appears to be a refinement

---

26 H.R. Cong. Rep. No. 95-1752, 95th Cong. 2d Sess. 91 (1978), 1978 U.S. CODE Cong. and Ad News 8983, 9007.

27 36 FERC ¶ 61,093, at p. 61,224.

of Opinion No. 699-D's broader statement that, to be deemed similar to a severance tax, the "bulk of the tax" must be based on "production factors." On review of these standards, we find that they are too vague and subjective, and improperly permit property taxes on the present value of reserves and lease properties in the state to qualify. Past or current production volumes and revenues are indeed "production factors" but they are factors that are used in judging the present value of all estimated future production from a lease or well.[28] Since the resulting valuation is of the remaining reserves, a tax on that value is a property tax and cannot qualify for reimbursement under section 110. Further, it is not feasible to establish any precise standard for deciding whether production is significant enough in the calculation of the Kansas *ad valorem* tax to qualify its bulk as being similar to a severance tax. Accordingly, we will not attempt to apply those standards here and, as directed by the court, will clarify the standard for analyzing whether the Kansas *ad valorem* tax qualifies under section 110.

At the outset, we believe that section 110's allowance for taxes "similar" to severance taxes was meant to reflect Congress' intent that the substance of the tax, and not its mere label, be dispositive of the issue. Thus, the fact that the subject Kansas tax is titled as an *ad valorem* tax is of no importance to the resolution of the issue here. However, by the same token, we believe that the substance of the tax must fit some common, historical definition of a severance tax. By Congress' own definition, such a tax must be "upon" gas production or the value thereof and not, for example, on personal property. It is

---

28 The fact that current producing rates may be one factor considered in valuing the fair market value of a gas producing property merely reflects the fact that potential purchasers of such a property will naturally value it greater if it is producing high volumes of gas. In such cases, the cashflow from the property is a known fact and the investors can expect to recover their investment more quickly than if daily production is low.

the tax basis -- current production or personal property -- that dictates whether the Kansas *ad valorem* tax qualifies under section 110.

Accordingly, to be deemed "similar to" a severance tax, a tax must have the substantive characteristics of a severance tax, and not a property tax. There are two essential characteristics of a severance tax. First, a severance tax is a tax on the act of severing, i.e., removing, a commodity from the earth. A severance tax is on the volume or value of the commodity removed, as assessed at the time of removal. A property tax is on the value of assets remaining in or on the earth at the time of the assessment. Thus, as relevant here, a gas severance tax is on the volume or value of the gas the moment it is produced; a property tax on gas leases or wells is on the value of the gas remaining in the ground as well as on the value of wells and other production assets on the lease, at the time of the tax assessment.[29]

Second, a severance tax in its purest sense is a tax on each Mcf or MMBtu of gas production, or the value thereof, at the time of production, although the state may bill the tax on a monthly or annual basis or may use some form of averaging of the production over the tax period.[30] The key point is that

---

29 The value of such production, in turn, is a direct function of the volumes produced and the price obtained for the gas, but may also reflect a netting out of the producer's cost of production, gathering or other factors. If there is no sale of the gas production, as in the case of gas used for gathering system fuel, or if the sale is at a location other than the wellhead, some states may require some sort of wellhead market value price be imputed to the gas for the purpose of the severance tax.

30 Thus, a tax on average or total production or production revenue over a current tax period, such as a tax year, could qualify as a severance tax since it is a surrogate for assessing the tax on each Mcf or MMBtu produced, or the revenue therefrom, during that period. As the court in CIG noted:

each time a single unit of gas is produced (i.e., "severed from the earth"), and only at that time, a severance tax liability arises directly proportional to the price and/or volume of the gas produced. There is a discrete event that triggers the severance tax liability -- the production of a unit of gas. And, once the unit of gas is produced and the severance tax is applied to it, that unit of gas is never again subject to the severance tax. On the other hand, a property tax on gas leases and wells can be on what an assessor estimates as the net present value of all expected future production from the lease or wells, and may reflect all future expected costs and prices, as well as future depreciation, salvage value of facilities and so forth and will be based, in part, on current and historical costs and production data. Further, and unlike a severance tax, a property tax is applied to a unit of gas reserves each year -- year after year -- until that unit of gas finally is produced and removed from the property being valued.

2. Application of Principles to the Kansas Ad Valorem Tax

Applying these common, historic principles to the Kansas *ad valorem* tax, we find that it is a tax on property, not on production, and, therefore, does not qualify for reimbursement under section 110.[31] On its face, and as applied

---

> If a state sought to capitalize the annual production (or revenue) enjoyed by each producer by multiplying it by a single fixed figure, the tax would plainly be similar enough to a production tax to qualify under § 110. CIG at p. 779 However, the Court specifically held that neither Texas nor Kansas does that. Id.

31 In this regard, we find that Kansas' own section 79-4217, which is described as an excise tax on the "gross value" of gas "severed from the earth," fits exactly the definition of an eligible "State severance production, or similar tax." The Kansas severance tax, Kansas Stat Ann.79-4217, provides, in pertinent part, as follows:

> Mineral severance tax; imposition of tax; rate; measurement

by the state appraisers,[32] the Kansas *ad valorem* tax statute establishes a tax on the present value of personal property. Past and current production is used to estimate future, total production capability of the lease or well which, in turn is used to assess the present value of the gas reserves at the time of the tax assessment. The present value of wells and other leasehold equipment is also included. Like any tax on the value of gas reserves, "production factors" are a significant part of the valuation process. But the thing being valued and taxed is not each Mcf or MMBtu of current production at the time of production; it is the present value of lease property, including the gas reserves remaining in the ground, that is being valued and taxed. Hence, each year -- year after year -- an Mcf of gas reserves in Kansas will continue to be valued and taxed under the Kansas *ad valorem* tax until that Mcf is eventually produced and sold. Only when that Mcf of gas is produced and sold, does the producer become subject to a tax that does qualify as a severance tax under section 110, i.e, section 79-4217 of the Kansas statute.

The affidavit submitted by CIG confirms that the Kansas *ad valorem* tax is primarily an asset or property tax, rather than a production or severance tax because it is based

---

of production; exemptions. (a) There is hereby imposed an excise tax upon the severance and production of coal, salt, oil or gas from the earth or water in this state for sale, transport, storage, profit or commercial use, subject to the following provisions of this section. * * * Such tax shall be applied equally to all portions of the gross value of each barrel of oil severed and subject to such tax and to the gross value of the gas severed and subject to such tax. The rate for such tax shall be 8 percent of the gross value of all oil or gas severed from the earth or water in this state and subject to the tax imposed under this act. ***

32 See appendix.

upon "the present worth of the anticipated reserves"[33] less the costs of operation. Thus, it is quite simply, a tax on the current net value of recoverable reserves. As CIG argues, what is being taxed "is not the value of current production, but instead, the value of the leasehold interest, recognizing that current production is a 'yardstick' by which the value of the leasehold is measured."[34] Also, contrary to the KCC, the fact that the Kansas *ad valorem* tax may be greatly reduced in the case of a shut-in well does not turn the tax into a severance tax. That would be a case of the tail wagging the dog. This one feature of the tax that applies in that narrow circumstance when there is no production is not indicative of how the body of the statute operates when there is production. When there is production, the tax is applied just like any other property tax. In any event, when there is no production, there still can be an *ad valorem* tax assessed on the well and other lease property. A true severance tax only applies when gas is produced.

We also concur with the court's analysis that the 1980 amendment supports the view that the Kansas *ad valorem* tax is a property tax. The amendment requires that current actual production from a new well cannot be the basis for the tax if future production rates from the well are expected to be lower. Furthermore, our decision here is not contradicted by the 1982 amendment (section 79-4219) of the Kansas statute. That section provides that taxpayers who are subject to *ad valorem* taxes get a credit to the Kansas severance tax (section 79-4217) in an amount equal to 1 percent of the gross value of gas severed and taxable under the severance tax. Because current production may be factored into the *ad valorem* tax valuation (albeit to better assess expected future production and, therefore, the value of the remaining reserves), and also is taxed

---

33 Hagemann affidavit, p. 3.

34 CIG Ans. at p. 25.

under the severance tax provision, the credit simply reflects that a small portion of the *ad valorem* tax may be somewhat redundant with a small (1 percent) portion of the severance tax. The relative insignificance of the credit vis-a-vis the total *ad valorem* tax base and resulting tax liability makes it abundantly clear that the *ad valorem* tax ultimately found due on a property is not "upon" current production to any significant degree.

B. Date of Application of the Ruling of this Case

Since we have concluded that the Kansas *ad valorem* tax does not qualify as being similar to a state severance tax under NGPA section 110, we must also determine the effective date of our decision. The issue before us is whether and, if so, to what extent this ruling should be made retroactively effective. A finding that our ruling should have prospective effect would have no effect at all inasmuch, as effective January 1, 1993, the statutory ceiling prices on natural gas were removed. Further, the date of enactment of the NGPA, December 1, 1978, is the maximum limit of potential retroactivity here because we have found that the Kansas *ad valorem* tax does not qualify under section 110 of the NGPA and, hence, reimbursement of that tax in addition to the ceiling violates the Congressionally-set maximum lawful prices. As discussed below, we do not view our authority as limited by the relevant case law to a choice only between maximum retroactivity and prospective application. Accordingly, we believe that there are a number of other relevant dates that could be considered for purposes of refunds: for example, the date the applicants sought a declaratory order in the instant proceeding (August 22, 1983); the date of the Commission's order in Sun (July 23, 1986); or the date of the CIG decision

(June 28, 1988).[35] Upon review of the relevant court standards of administrative retroactivity, we conclude that our ruling should be applied retroactively to the date of the court's decision in CIG, June 28, 1988.

In its recent decision in *Williams Natural Gas Co. v. FERC*, Nos. 90-1545 and 91-1543, (September 21, 1993) (Williams), the United States Court of Appeals for the District of Columbia Circuit discussed the question of retroactive application of administrative agency rulings. The court explained that, although a precise statement of the factors to be considered has varied from case to case, it has typically applied the following factors initially set forth in *Retail, Wholesale & Dept. Store Union v. NLRB*:

> (1) whether the particular case is one of first impression, (2) whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law, (3) the extent to which the party against whom the new rule is applied relied on the former rule, (4) the degree of the burden which a retroactive order imposes on a party, and (5) the statutory interest in applying a new rule despite the reliance of a party on the old standard.[36]

---

35 We do not consider the date of Opinion No. 699-D, October 1974, as a viable option, related to the NGA and this proceeding involves application of the statutory definition under the NGPA. Moreover no party has urged such a date.

36 466 F.2d 380, 390 (D.C. Cir. 1972) (Retail Union). In the past the Commission has applied the standards for judicial retroactivity set forth in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971) (Chevron v. Huson). See, e.g., *Dorchester Gas Producing Company*, 36 FERC ¶ 61,049 (1986), aff'd *Dorchester Gas Producing Co. v. FERC*, 848 F.2d 636 (5th Cir. 1988). In *District Lodge 64, Int'l Ass'n of Machinists & Aerospace Workers v. NLRB*, 949 F.2d 441 at p. 447 (D.C. Cir. 1991), the court noted that the Retail Union test concerning retroactive

However, the court in Williams did not review each factor as so stated and, instead, stated that, in applying the various versions of the Retail Union test, there has emerged "[a] basic distinction . . . between (1) new applications of law, clarifications, and additions, and (2) substitution of new law for old law that was reasonably clear."[37] The court explained that in the latter context, which may give rise to questions of fairness, "it may be necessary to deny retroactive effect to a rule announced in an agency adjudication in order to protect the settled expectations of those who had relied on the preexisting rule."[38] In the former case, it held, retroactivity is "natural, normal, and necessary."[39] Thus, the court stated, "we have repeatedly held that retroactivity is appropriate when the agency's ruling represents 'a new policy in a new situation,' rather than being 'a departure from a clear prior policy.'"[40]

This case involves a bit of both situations. On the one hand, as the court admonished in CIG, the Commission in Sun had no clear standard of analyzing state taxes for purposes of qualification under section 110. Today we are announcing that the common, historical standards for distinguishing between severance taxes and property taxes are to be applied. That would suggest full retroactivity. On the other hand, our ruling

---

application of agency decisions appears substantively indistinguishable from the standard set forth in *Chevron v. Huson*. But see *Harper v. Virginia Dept. of Taxation*, 61 U.S.L.W. 4664 (U.S. June 18, 1993).

37 Williams slip op. at p. 19 (citing *Aliceville Hydro Assocs. v. FERC*, 800 F.2d 1147, 1152 (D.C. Cir. 1986).

38 Id.

39 Id. (citing *NLRB v. Bell Aerospace*, 416 U.S. 267, 294 (1974)).

40 Id.

today clearly reverses an earlier Commission ruling that the Kansas *ad valorem* tax qualifies under section 110. As noted previously, the FPC had held in 1974 that the Kansas *ad valorem* tax was a "severance or production tax merely bearing the title *ad valorem* tax," and eligible for upward adjustment from the applicable national rate. Enactment of NGPA section 110 using the terminology of the FPC, and with the Conference Report stating that the provision concerning reimbursement of severance taxes should be "construed broadly,"[41] would, as the court noted in CIG, lead producers as well as purchasers to assume that the "Commission's earlier classification of the two states' taxes [Kansas and Texas] would carry over to the new regime."[42] Moreover, the Conference Report went on to add that the term severance tax "includes any tax imposed upon mineral or natural resource production including an *ad valorem* tax or a gross receipts tax."[43] That would suggest no retroactivity.

We think that the balance tips in favor of partial retroactivity. The "settled expectations of those who had relied on the preexisting rule" established by the Commission's several prior rulings on the Kansas *ad valorem* tax were changed by the CIG decision, not really our own decision today. Before that date, the parties could justifiably expect to recover Kansas *ad valorem* taxes in addition to NGPA ceiling rates with no expectation of a later refund obligation. After that date, given the clear signal by the court in its decision, the parties no longer would have been justified in relying on the Commission's earlier rulings with any assurance that they

---

41 H.R. Conf. Rep. No. 1752, 95th Cong. 2nd Sess. 91, reprinted in 1978 U.S. Code Cong. & Adm. News, pp. 8800, 9007.

42 850 F.2d at p. 772.

43 Id.

would not later be required to make refunds of *ad valorem* taxes and could have taken steps to protect themselves, such as establishing an escrow account for such tax reimbursements. Our decision today merely adopts the court's analysis of the issue and rules in a way, we think, fully expected of this Commission by the court. For these reasons, we believe the date of the CIG decision most appropriately accommodates the Williams criteria, rather than either a fully retroactive application back to December 1, 1978, or a fully prospective application (with no effect whatsoever).

C. Refund Procedures

1. Procedures for Refunds by First Sellers

First Sellers who collected revenues in excess of the applicable maximum lawful price established by the NGPA as a result of the reimbursement of the Kansas *ad valorem* taxes for sales on or after June 28, 1988, shall refund any such excess revenues to the purchaser, including interest in full within 180 days after the Commission's final order is issued. The refund period will commence when the Commission's order becomes final.

2. Procedures for the Flowthrough of Refunds by Pipelines

Under the Natural Gas Act, the Commission has jurisdiction over the rates interstate pipelines charge their customers. We establish the following procedures for interstate pipelines to pass through any *ad valorem* tax refunds they receive from first sellers.

a. Method of Flowthrough by Interstate Pipelines

Due to the implementation of Order No. 636 [FERC Statutes and Regulations ¶ 30,939], interstate pipelines have terminated their PGA clauses, which included a mechanism to pass through any refunds they received. Since this mechanism was used to reduce a pipeline's unrecovered purchased gas costs balance which would normally have been recovered from its customers over the next twelve-month period, this mechanism usually did not result in the flowthrough of refunds to customers in the same relative proportions of the actual overcharges because of changes in purchased gas patterns.

Since the PGAs have been terminated, *ad valorem* tax refunds can no longer be flowed through the PGA clause. In place of the PGA clause, pipelines have implemented PGA close-out procedures. However, these close-out procedures may result in methodologies that are even more divergent from the proportionate sales ratios reflected in the PGAs. Therefore, to ensure that *ad valorem* tax refunds will be made to customers who overpaid the pipelines and to avoid the problems of allocating these refunds to a pipeline's current customers, the Commission will require interstate pipelines to make a lump-sum cash payment to the customers who were actually overcharged. We will require pipelines to make refunds to the customers actually overcharged within 30 days after receipt of refunds from the producers. If a pipeline does not make refunds within this 30-day period, the interest provisions in section 154.67(c) will be triggered and interest must be paid from the date the pipeline receives the refunds from the producers until the date the pipeline pays refunds to its customers.

The Commission believes that a pipeline should: (1) allocate the refunds between jurisdictional and non-

jurisdictional customers, and (2) allocate the total refunds due to the jurisdictional customers who were actually overcharged based on the proportion of each customer's purchases during the refund period compared to the total jurisdictional sales during the refund period. Pipelines would then pay this refund to those customers in a lump-sum cash payment. In any event, pipelines are to process *ad valorem* tax refunds from other pipelines in the same manner as *ad valorem* tax refunds received from first sellers because this procedure will return such amounts to those customers actually overcharged.

Finally, the Commission notes that pipelines will not be required to be guarantors of refunds. However, the Commission urges interstate pipelines to actively pursue refunds owed by first sellers.

b. Pipeline Refund Reports

The Commission will require interstate pipelines to file refund reports showing the amounts they received from producers (with principal and interest shown separately) and any producers who still owe refunds. The report must be filed 75 days after the date refunds are paid.

The refund report must also describe the basis a pipeline used to apportion the refunds among its customers and be served on all of the pipeline's customers. These reports will enable the Commission to assure that the customers have received appropriate refunds.

The Commission orders:

(A) The Kansas *ad valorem* tax does not qualify as a production, severance or similar tax under section 110 of the NGPA.

(B) The Kansas Corporation Commission's motion to reaffirm is denied.

(C) The Kansas Corporation Commission's motion to lodge is granted.

(D) The Kansas *ad valorem* tax may not be added to the maximum lawful price under section 110 of the NGPA on or after June 28, 1988.

(E) Any first seller that collected revenues in excess of the applicable maximum lawful price established by the NGPA as a result of the reimbursement of the Kansas *ad valorem* taxes for sales on or after June 28, 1988, shall refund any such excess revenues to the purchaser, including interest calculated in accordance with §§ 154.102(c) and (d) of the Commission's regulations, in full within 180 days after the Commission's final order is issued, and shall file a refund report with the purchaser's concurrence within 75 days thereafter.

(F) Interstate pipelines must follow the refund flowthrough procedures set forth in the text above.

Appendix

The Kansas Ad Valorem Tax

The ad valorem tax at issue is part of the general Kansas property tax imposed by Articles 79-1 through 79-28, Kansas Statutes Annotated. The properties are assessed by local assessors and taxed by local taxing jurisdictions within Kansas. Section 79-329 of the Kansas Statute defines properties that are capable of producing oil or natural gas in paying quantities, together with all casing, tubing or material thereon, as

"personal property" and, therefore, subject to Kansas *ad valorem* taxes. Section 79-330 provides that, in valuing such properties for the purpose of tax assessment,

> there shall, in addition to the value of all oil-or gas-well material in or upon the leasehold properties, be made such valuation of the oil or gas wells as would make a reasonable and fair value of the whole property.

Section 79-331(a) states that in determining the value of oil or gas leases or properties, the appraiser shall take into consideration:

> the age of the wells, the quality of the oil or gas being produced therefrom, the nearness of the wells to market, the cost of operation, the character, extent and permanency of the market, the probable life of the wells, the quantity of the oil or gas produced from the lease or property, the number of wells being operated, and such other facts as may be known by the appraiser to affect the value of the lease or property.

Section 79-331(b) establishes an exception to section 79-331(a) in the case of new wells. Paragraph (b) provides that if a new well commenced production on or after July 1 of the preceding year, the actual production during the remainder of that preceding year will be reduced to 60 percent of that actual volume and then annualized. In Sun, the Commission explained that this latter provision was designed to correct for the unusually high production rates of new wells ("flush production") in estimating production in subsequent periods. 36 FERC ¶ 61,093, at p. 61,224 Section 79-501 requires that

tangible personal property shall be appraised at its fair market value which section 79-a defines as "the amount in terms of money that a well informed buyer is justified in paying and a well informed seller is justified in accepting for property in an open and competitive market, assuming the parties are acting without undue compulsion." Section 79-a goes on to list various factors that are to be considered in determining fair market value, in addition to sales, such as location, depreciation, cost of inter alia, by capitalization of net income.

In CIG, the court described how the Kansas *ad valorem* tax is calculated:[1]

> The market value of annual production is calculated by multiplying past production (averaged over a three- or five-year period where available) by the price actually paid the producer on January 1 of the assessment year. Kansas then capitalizes annual production (i.e., infers a present capital value from income expected to be received over the future) by multiplying it by a "present worth factor" or "PWF."

As would any capitalization formula, the PWF incorporates an assumed discount rate and expectations as to future price changes. Because natural gas is an exhaustible resource, the PWF also builds in assumptions (or information) about rates of decline in production and the probable length of production; these naturally vary from property to property.

* * * * *

1 850 F.2d at p. 771.

The PWFs in Table B range from 3.915 (for a zero decline rate and an eight-year life) to .673 (for a 50% decline rate and a five-year life). After annual production is multiplied by the PWF, the resulting figure is adjusted downwards for operating costs and upwards for the assumed value of equipment. Although production plays an important role in tax computation, the variation caused by other elements-included because of the state's interest of ascertaining capital value-may make the ultimate tax on equal production vary nearly by a factor of ten.

The court's description is consistent with the description of how the tax is determined in the affidavit of a Timothy N. Hagemann, a Kansas Certified County Appraiser, submitted with the Kansas Corporation Commission's (KCC) motion to Reaffirm. The affidavit states that:

> (1) The appraiser first determines the well's "total average gas production." For a property in a major proven gas field, the total average production is the numerical average of production for the previous five years or the adjusted volume, after consideration for overages, underages and anticipated curtailed volumes. If the property is located in a field that is not considered a major field, the total average production is the numerical average of the past year's production.[2] The amount of

---

2 According to the Hagemann affidavit, the appraiser may adjust actual production figures to account for abnormal events. Thus, if production had been curtailed and then suddenly was resumed, the appraiser would adjust his assessment upward to reflect the anticipated increase in production for the upcoming year. Conversely, if a well has been overproducing and has exceeded its allowable production, the assessment will be lowered to reflect the anticipated curtailment.

remaining recoverable reserves are not taken into consideration.

(2) The appraiser then multiplies the absolute average production by the "net price received." The net price received is the price of gas as of January 1 of the tax year.

(3) Next, the appraiser multiplies the estimated gross income stream by the "present worth factor" or "present value factor." The present worth factor is the product of (1) the rate of decline of gas reserves, (2) the assumed rate of increase in the value of gas, and (3) the present value discount factor. Present worth factors are promulgated by the Department of Revenue for each major proven gas field and are identical for all properties within the field. For properties in other fields, the appraiser must calculate the reserve decline rate based on the prior two year's production.

* * * * *

(4) Finally, the appraiser adjusts the gross reserve value by deducting an allowance (fixed by the Department of Revenue for each field) for the present value of future operating costs. The appraiser also adds a standard amount to reflect the value of equipment, if applicable.

The result of all these calculations is the total "appraised value of gas production." The applicable tax rate is applied to 30 percent of the total appraised value.